STATISTICAL AND SOCIAL INQUIRY SOCIETY OF IRELAND.

CAPITALISM AND CRISES.

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I.

The paradox of economic distress in the midst of plenty, so prominent in the present depression, appears to be exercising people's minds in a most disturbing manner. The world is apparently glutted with commodities of all sorts; the machinery of production has reached a pitch of efficiency never known before; and yet millions have to go short. Moreover, this very abundance and efficiency stand in the public mind as the *cause* of depression and unemployment. A curse of plenty that resulted in over-luxuriance of society might be intelligible, but a curse of plenty that shows itself in poverty and hunger does not make sense.

This apparent absurdity is being taken as marking the climax of a long-latent error in the social system. Many people take it to presage the downfall of Capitalism. There are even some who believe that civilisation itself is in danger. Thus Mr. H. G. Wells, writing on the present crisis recently, referred to the " collapse of our civilisation which is already manifestly going on." He said: " Unexampled prosperity and happiness is within reach of our race, and it staggers on the edge of what may be irrevocable disaster. Every year, every month of indecision increases the inevitability of that disaster."

In such a state of tension the public is apt to give credence to the most fantastic theories. On the one side there are avowed Capitalists, who believe that salvation depends alone on the error being discovered and corrected in time by State action. The banking system has become suspect, and one hears talk of drastic monetary reform. They tell the patient he must have an operation, but they do not know what to operate for.

At the other extreme are the Communists, who see in the present impasse a fulfilment of the prophecies of Karl Marx. For them, the whole order needs to be scrapped. These appear to be gaining many adherents. The Communists can claim at least that the problems of the Soviet Union are free from paradox. There may be poverty in Russia, but it is at any rate due to economic scarcity and not to affluence. With the Soviets the remedy is to work harder and consume less; with us the call is to share work and spend more.

Undeniably the present situation does hold a menace to the social order. In the United States, Germany and Great Britain alone there are some twenty million people out of work for years, with little hope for the future, slowly organising in their distress. In Middle Europe a fresh financial collapse is threatened. Everywhere there is an economic stampede. The nations seem bent on a policy of *sauve qui peut.* In such a welter society might well lose itself.

But whatever danger there is lies solely in these superficial elements of the depression. It is not inherent. The world is in the plight of an overladen boat, where panic and commotion may bring disaster, but steadiness means safety. The fundamental economic position is not unsound. On the contrary, the present efficiency of production holds the promise of a measure of prosperity greater than the world has ever known. The paradox above referred to does not mean that Capitalism has reached a climax, and it is not peculiar to the present depression but has shown itself again and again in the past.

Just over a hundred years ago, in a parallel situation, men were talking in a similar strain. A decade later, and again two decades later there was also an army of hunger-marchers, but always there was a recovery in trade. Two hundred years ago the great crash of 1721 frightened society into the same uneasy introspection. Going back only a few years, we find that people were making the same error, though in the opposite sense. In the boom of 1929 high authorities in America believed that society had shaken itself free of the old economic laws and was entering the Millennium of prosperity. President Hoover's Committee on "Recent Economic Changes," reported in the most glowing terms that the country had a "boundless field before it economically," and had touched "only the fringe of its potentialities." Almost on the eve of the panic Professor Irving Fisher assured the public that there would be nothing in the nature of a crash, and said: "We are living in an age of increasing prosperity and consequent increasing earning power. This is due in a large measure to mass production and inventions such as the world has never before witnessed." But just as the boom did not last in 1929 so we may predict to-day that the depression will not last. In the last boom Mr. Roger Babson was constantly using the historical argument to warn the public. Only a few weeks before the panic of October 18 he said: "The Economic Cycle is in progress to-day as it was in the past. Sooner or later a crash is coming, and it may be terrific. Wise are those investors who now get out of debt and reef their sails."

The existence of this phenomenon referred to by Mr. Babson, the Economic Cycle, cannot now be denied. It is characterised by recurring periods of prosperity, each period followed by crisis, depression, recovery, and so on. Admitting it, we can place the present depression in a true perspective and see it as a transient difficulty and not a complete breakdown.

Taking the course of average annual wholesale prices since the commencement of last century, and eliminating therefrom the secular trends (arising mainly from changes in the gold supply), the Economic Cycle will show up unmistakably as a fairly regular festoon-like curve, the upward sweeps coinciding with the known periods of business prosperity, the downward swings coinciding with periods of depression, and the peaks marking the financial crashes. The dates of the crises since 1800 are:—1810, 1818, 1825, 1837, 1847, 1857, 1866, 1873, 1882, 1890, 1900, 1907, 1920 and 1929. These dates give an average period of about 9 to 10 years between each crisis. Statistics relating to the eighteenth century are very meagre, but we know that there were outstanding financial crises in 1721, 1745, 1763, 1772, 1782 and 1793. Thus, the Economic Cycle has been in evidence since the beginning of the modern industrial and financial system. It has operated both when the secular trend in prices was upward and when it was downward; it has been present under widely different monetary conditions, paper standard, bi-metallic standard and gold standard. Finally, the Economic Cycle is not peculiar to any one country but has an international sweep.

Generations of economists have been at pains to account for this curious phenomenon; and a great variety of theories has been advanced. These theories may be classified into four main groups in accordance with the various lines of approach to the problem.

In the first group each cycle is seen as an isolated occurrence which must be studied by itself, and is explainable, not by reference to the preceding cycle, but by accidental circumstances, such as wars, inventions changes of fashion, financial events, etc.

Most theories reject this view, and agree in treating each succeeding cycle as part of a continuous whole. Thus a second group regards the Economic Cycle as the result of a fatality in human affairs produced by a corresponding rhythm in the physical world. Of this group the most famous is Professor Jevons' theory linking up the sun-spot cycle with an indicator curve for industrial fluctuations (pig-iron production) through corresponding cycles claimed for weather conditions and harvest yields. Many of the ideas in this category have been worked out with great plausibility, but they would appear to rest largely on pure coincidence.

A third group of theories proceeds from the idea that there must be some master-factor running through economic life of a nature to produce these cyclical fluctuations, the discovery of this factor being largely a matter for statistical research. The controlling force may be a single economic process, such as the course of interest rates, the price of silver, or it may be a concatenation of two or more processes, such as the relation between the flow of savings and the opportunities for investment. Much of the modern statistical research appears to be prompted by this idea. The construction of "economic barometers" is largely a quest for the secret of this "forecaster curve," betraying the hidden stimulus whose disclosure will enable one to forecast the future. Generally it may be said of the theories in this group that they fail to define the initial stimuli in the Economic Cycle. For the most part they single out movements which, far from explaining the Economic Cycle, can only be explained themselves as the effect of the cyclical motion.

In a fourth group of theories the Economic Cycle is explained by human fallibility. It is argued that the cyclical movement is due to periodic overproduction due to miscalculation by business people in laying their plans for the future. Thus, Professor Pigou pictures the typical cycle as consisting of alternating periods of contagious over-optimism and contagious over-pessimism on the part of the business community, the error in each phase being cumulative, and the transition from one phase to the other occuring when the error becomes manifest. (Incidentally this theory, in common with a great many others, is consistent only with a form of movement where the change from prosperity to depression and again from depression to prosperity is either abrupt in both cases or gradual in both cases. In the actual cycles of which we have experience the change from prosperity to depression is invariably abrupt, being marked by a financial crisis, but that from depression to prosperity is generally a gradual transition.)

It may be noted here that nearly all the theories take it for granted that the Economic Cycle is an abberation, which it behoves economic science to rectify.

Professor Pigou's theory is in reality little more than an *ex post facto* supposition. It comes very near saying that business moves in cycles because it does not move in a straight line. One is forced to ask: What then is this theoretical rate of production from which any departure is an error? The answer might be: That rate which will maintain a supply of commodities so conforming with demand that there will be no periodic upward or downward swings in the price-level (i.e., apart from the secular movements.) But this merely begs the question.

Nor is it in accordance with the realities to say an error of over-production becomes manifest before each crisis, the revelation of which produces the crisis. For example, in the trade boom of 1919 the position was that the shops and the public were clamouring for goods of all sorts faster than the producers could turn them out. In many motor factories, for instance, production was booked up eight months ahead. This position continued right up to the crisis, and then within the space of a few weeks the whole situation had suddenly changed; the public were no longer buying and orders were being cancelled all round. The sudden change, however, does not disprove the fact that just before the crisis there appeared to be a state of *underproduction* instead of obvious overproduction.

Besides, although one may speak of overproduction in a particular commodity, one can hardly postulate a state of *all-round* overproduction. If more of every commodity is being produced, then obviously there is also being created the basic capacity for an all-round increase in consumption as well. The world is a very long way from the saturation point in general consumption. In the last analysis production and consumption are nearly identical, as Professor Seligman argues. It is largely true that an increase in production automatically means an increase in consumption. At any rate it is very hard to see why even a rapid increase in production should be an error, why consumption could not be maintained indefinitely at the higher level.

II.

Without attempting to work out a theory of the Economic Cycle, I would put forward a three-fold suggestion:—

> The first is that the driving stimulus in the Economic Cycle derives from one of the latent forces in human nature, this force being what I shall provisionally call the speculation urge
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> The second is that the Economic Cycle must be regarded, not as an aberration from a theoretical economic norm, but as the natural mode of economic progression.
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> The third is that the cyclical form of motion is not an economic disease to be cured, but in fact an essential to rapid expansion such as the world has experienced during the past hundred and fifty years.

My belief is that the key to the problem lies in the Stock Exchange. Every major financial crisis has been preceded by a boom in paper values. Without this boom there would be no crisis and, I suggest, no Economic Cycle.

A Stock Exchange boom is not possible unless the banks are lending freely and unless the general public, as well as the professional operators, are interested in the markets. After a period of falling prices the banks inevitably have a large reserve of lending power, and advancing money against marketable Stock Exchange securities is at once the easiest and seemingly the safest and most remunerative form of banking. The second condition is fulfilled by the fact that there are at all times millions of people ready to take a chance of making easy money.

I have called the spirit behind a boom in securities the "speculation urge," but this term is inadequate. A Stock Exchange boom is not speculation in the sense of a reasoned balancing of risk against probable reward, nor yet is it mere gambling in the sense of staking money on pure chance. The spirit at the back of it is rather a lust for easy money, an irrational ambition to escape from cold economic realities. It is much the same as the spirit that manifests itself in the never-failing popularity of lotteries and betting and the lure of hidden gold.

The institution of the Stock Exchange is peculiarly adapted to give the fullest play to this urge. It affords an opportunity of making substantial sums of money in a short time with little or no effort beyond ringing up a banker or broker. This opportunity is not even confined to people of substance and means; those without capital can also have flutters in the markets. The speculator need not even be or become a shareholder. He can sell shares he never owned and buy shares he never intends to own. It is possible for the whole stock of a particular company to stand as sold simultaneously to several complete sets of buyers. No other human arrangement offers such facile, unbounded and universal opportunities for making easy money.

Now, a Stock Exchange boom is always irrational. The advance in prices may commence selectively, on a basis that can be justified by balance sheets, but sooner or later calculation is laid aside, and good and bad shares are swept in a contagion up to levels that cannot possibly be justified by reference to equities or dividends. More remarkable still: the boom can still go on even after it becomes generally obvious that values have reached fictitious levels. The financial expert may even be wrong in recommending a sale of a particular share which he knows to be greatly over-valued, because so long as the public keeps buying it is bound to go still higher. When it become obvious that the boom has carried stocks above intrinsic values the public seems to play a vast confidence trick on itself. For instance, during the 1929 boom in New York, Wall Street was seriously declaring that Stock Exchange speculation was "a business in itself" which could be carried on without reference to outside conditions. To those who drew attention to the fact that even the most sanguine dividend prospects could not justify values the answer was: We are not buying for investment but for capital appreciation. In short, the position in a Stock Exchange boom is really that prices are rising because everybody is buying and everybody is buying because prices are rising, and the conspiracy holds together so long as the banks keep lending.

Reference to conditions in the United States during the 1929 boom will show that the above description is not exaggerated. It was estimated that during the boom there were as many as fifteen million persons playing the markets. The daily sale of shares frequently exceeded six million in number. The physical machinery of the Stock Exchange was constantly breaking down under an avalanche of orders. Conditions were described as follows by the *Financial and Commercial Chronicle*: " Everyone became seized with the idea that it was possible to get rich overnight by simply taking flyers in the stock market. Scrub-women, porters, elevator boys, typists, bootblacks, soda-fountain attendants, clerks, statisticians, actors and actresses, business executives—in fact all classes of the population from the humblest to those clothed in state became a prey to the consuming speculative craze." At the height of the boom, loans for Stock Exchange speculation, attracted by rates ranging from 6 per cent. to 25 per cent., reached the staggering total of over $8.500,000,000, a figure which is nearly three-quarters of the regular trading credit extended by all the bankers combined in Great Britain and Ireland. Similar conditions generally existed during booms in the past.

Given a major Stock Exchange boom such as I have described, a financial crisis is inevitable. If those playing the markets had to pay cash, and take delivery, every time a share was bought, the rise in values would obviously be limited by the amount of cash available for investment. But if the banks are lending freely to enable shares to be carried, then the rise is limited only by the amount which the banks are prepared to advance. If the banks stop giving fresh credit, then the circle of buying is broken perforce. If the banks go further and call in loans, those who are overbought are forced to sell, and since the circle of buyers has then become narrowed, prices must fall. The speculators who, in the popular phrase, are " holding the baby " suddenly panic and throw their commitments on the market for any price they can get. Since the banks' lending power is not inexhaustible this *denouement* is inevitable.

The relation between a Stock Exchange boom and the Economic Cycle has next to be examined. A necessary anterior condition to a boom is a period of profitable trade. A boom cannot spring out of a trade depression. Now, during a depression, where losses are the rule, producers and traders everywhere, taking the purely accounting point of view, are struggling hard in order to cut costs. Their united efforts must sooner or later succeed in forcing a readjustment as between expenses and selling prices, enabling them to resume profitable working. When this stage is reached, trade and prices will begin to steady. In a little while companies whose issues are quoted on the Stock Exchanges will be showing profits. Gradually arrears of fixed-interest charges will be paid off, and dividend prospects on ordinary shares will be brightened. Each fresh crop of company reports will now be showing a little improvement.

At this stage the professional element in the Stock Exchange will begin to mark up prices. Gradually this movement will attract speculators. Banks will have more confidence. As the buying circle is enlarged share prices will go higher, which in turn will attract more buyers, and so on until eventually there is a big public playing the markets and all is set for a boom.

The cycle of speculation in securities runs parallel to the business cycle. A Stock Exchange boom is usually accompanied by a period of great expansion in trade. The question is: Which is the cause, and which the effect; or are they both the effect of a common outside cause? I am suggesting that in the typical cycle the irrational movement is the cause; that the exuberance of a Stock Exchange boom, which is largely a trading in fictitious values, is capable of stimulating real trade from mere steadiness into intense activity.

During a rapid rise in Stock Exchange securities every speculator is making profits. Nobody is losing money. Also, the company promoter is very active. Frequently the volume of new flotations is colossal during a boom. These conditions create an atmosphere of spending, and also furnish the means to spend, by sluicing into the commodity markets some of the bank credit advanced for speculation. The man who finds himself making large profits on paper, will naturally enlarge his ideas as to what he can afford, and is likely to cash in portion of his profits from time to time for spending, or perhaps to enter into hire-purchase and other consumer credit commitments which he would normally avoid. The activity of the New Issue market also sets up a new demand for commodities running into scores, perhaps hundreds of millions over a short period.

Professor Pigou's theory, notwithstanding, it is difficult to see how a condition of merely steady trade all round could develop into one of intense activity without some special outside stimulus, and it is certainly arguable that speculation in paper values can provide that stimulus, in the manner above described. This view accords with the statistical facts, which show that the stock markets generally move in advance of trade during the upward swing. In 1929 this position was well recognised in the United States, where one frequently heard the phrase: "Wall Street is taking business for a ride."

Time does not permit of any further elaboration of the problem here. It may be noted, however, that this view of the Economic Cycle avoids the very questionable assumption that an all-round expansion in production is an error, which must inevitably correct itself by a depression. It does not predicate that the *entrepreneur* can be overproducing at a time when he sees everybody is buying, as during a trade boom, or that he is somehow in error again during a depression, when it is only too clear to him that demand has fallen off. Moreover, it affords an explanation as to why these cyclical fluctuations are far from disappearing, despite a century of commercial and financial experience, and despite a great weight of tendencies *against* instability in prices and incomes, such as industrial concentration, trade agreements, the Trades Union movement, the spread of life assurance and small savings, the growth of the professional and salaried classes, the social services. It sees the Economic Cycle not as due to something inherent in business itself, but as caused by an irrational element in human nature. This element, which I have called the desire for easy money, for want of a better description, produces a boom in paper values once it is allowed free play. The boom induces an expansion in real trade, but is of such a nature that it must end sooner or later in a financial crisis, which in turn precipitates the depression. Thus, although the initial motive force is always latent, once exerted, it induces a train of consequences which automatically compel it into quiescence again until the force is fully expended.

III.

If the foregoing explanation is correct, then one must agree with Karl Marx that in a Communistic world what is known as the Economic Cycle would disappear. If private property is abolished, and all possibility of private gain, then there will be no opportunity for private speculation and consequently no boom and no financial crisis. Economic life would still be subject to disturbances arising from short-period maladjustments and from the broader secular changes. But the stimulus behind the Economic Cycle could find no place in the card-indexes of bureaucratic Communism.

Where one may disagree with Karl Marx, however, is in using this as an argument *in favour* of Communism. The spirit behind a gamble in paper values is in a sense a revolt against the factors making for excessive economic standardisation. It is a healthy unrest. It expresses a dissatisfaction with things as they are and a demand for constant advance. It is the spirit that creates a call for new inventions, applies the discoveries of science to human needs, sends out the prospector and explorer and encourages bold enterprises. It is to economic life what the racing motorist or the Atlantic flyer are to engineering. Foolhardy though they may be, yet their exploits are necessary to advancement. Is it not possible that if this spirit were denied expression in economic life, material progress would be slowed down and society would stagnate?

The cyclical form of movement is peculiarly favourable to rapid material progress. It produces periods of luxuriance during which industry is jolted out of the groove of custom, new commodities are launched into production and the luxuries of yesterday broadened out into commonplace consumption. Alternating with these are periods of retrenchment during which the productive organisation has time to adjust itself to the new standard of consumption, while the public appetite is whetted. In the enthusiasm of the boom capital is found for new inventions, processes and improvements of all sorts, which would otherwise remain on the shelves. For every class of the community is set a new position to be maintained, a slightly higher standard of living towards which ambition must strive. In the ensuing depression there is no destruction. Rather is the previous advance consolidated. Industry is forced to rationalise, to cut out waste and inefficiency to a degree that would not be possible without the spur of hard necessity.

The foregoing view would deny any validity to the old theory of Socialist thinkers that the Economic Cycle will eventually bring about the destruction of the Capitalist system, that financial crises will become more and more frequent and severe, until eventually there will come a shock which Capitalism cannot survive. Our whole detailed experience of the Economic Cycle, extending over the past two hundred years, is one of economic expansion more rapid than in any previous two hundred years' of world history. Each cyclical wave has lifted the mass of the people towards a higher standard of living, at a time when world population has been growing at a phenomenal rate. Despite the depression, there are to-day more men and women in gainful employment than there were before the Great War. One can hardly deny the reality of material progress when one reflects on the variety of products in common consumption to-day which were either unknown or the luxuries of the few before the war—motor cars, cinematography, gramophones, radio, domestic labour-saving devices, not to mention the greater costliness of furniture and wearing apparel in common use, the increased consumption of meat, the greater profusion of magnificence. Comparison with various periods in the last century will afford still more striking contrasts. If all this progress has been helped by the Economic Cycle, and if this phenomenon is a peculiarity of the Capitalistic system, meaning that system which allows the fullest play to desire for private advancement, then Capitalism is to-day more potent than ever before. If the present plight were one of famine or even scarcity of commodities, then indeed the system might be condemned. But the present position is rather an *embarras de richesses.* The productive process is only too efficient, seemingly too prolific. If this is a fault, at least it shows vigour, not decay. A state of superabundance would be hailed as a triumph for Communism. Surely it is no less a triumph for Capitalism.

In conclusion it may be appropriate to quote from what Macaulay wrote in 1830, during a similar depression, the chief point of which is its aptness to-day: "If we were to prophesy that in the year 1930 a population of fifty millions, better fed, clad, and lodged than the English of our time, will cover these islands, that Sussex and Huntingdonshire will be wealthier than the wealthiest parts of the West Riding of Yorkshire now are, that machines constructed on principles yet undiscovered will be in every house, that our debt, vast as it seems to us, will appear to our great-grandchildren a trifling encumbrance, which might easily be paid off in a year or two, many people would think us insane. . . . We cannot absolutely prove that those are in error who tell us that society has reached a turning-point, that we have seen our best days. But so said all before us, and with just as much apparent reason. . . . On what principle is it that, when we see nothing but improvement behind us, we are to expect nothing but deterioration before us?"

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